



FEDERAL ELECTION COMMISSION
WASHINGTON, D C 20463

August 9, 2005

FEDERAL ELECTION
COMMISSION
OFFICE OF GENERAL
COUNSEL

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MEMORANDUM

TO: Lawrence H. Norton
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THROUGH: James A. Pehrkon
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Deputy Staff Director

FROM: Joseph F. Stoltz
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Audit Division

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AUDIT REFERRAL # 05-06

SUBJECT: Americans for a Republican Majority (A03-43) – Referral Matters

On July 28, 2005, the Commission approved the final audit report on Americans for a Republican Majority (ARMPAC). The final audit report includes the following matters that are referable:

- Finding 3 – Non-Federal Funding of Federal Activity:
On 5/18/05, ARMPAC reimbursed the non-federal account \$60,728 of the \$203,483 over funding.
- Finding 1 – Misstatement of Financial Activity¹ and Finding 2 – Reporting of Debts and Obligations|
However, Audit Division policy dictates if one matter is referred to your office, other matters referable to ADR shall also be referred to your office.

Based on the above, the Audit staff suggests careful consideration should be given to the extent of resources utilized by your office to pursue these matters.

All workpapers and related documentation are available for review in the Audit Division. Should you have any questions regarding this matter, please contact Jim Miller or Alex Boniewicz at 694-1200.

Attachments: Finding 1 – Misstatement of Financial Activity
Finding 2 – Reporting of Debts and Obligations
Finding 3 – Non-Federal Funding of Federal Activity

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Finding 1. Misstatement of Financial Activity

Summary

A comparison of ARMPAC's reported figures to its bank records revealed that receipts and the ending cash balance had been materially misstated for calendar year 2001 as well as beginning cash-on-hand, receipts, disbursements and ending cash-on-hand for calendar year 2002. The Audit staff recommended that ARMPAC amend its disclosure reports to correct the misstatements. In response to the interim audit report, ARMPAC filed amended reports that materially corrected the misstatements noted above.

Legal Standard

Contents of Reports. Each report must disclose:

- The amount of cash on hand at the beginning and end of the reporting period;
 - The total amount of receipts for the reporting period and for the calendar year;
 - The total amount of disbursements for the reporting period and for the calendar year; and
 - Certain transactions that require itemization on Schedule A (Itemized Receipts); Schedule B (Itemized Disbursements) or Schedule H4 (Joint Federal/Non-federal Activity Schedule).
- 2 U.S.C. §§434(b)(1), (2), and(4).

Facts and Analysis

The Audit staff reconciled reported activity to bank records for calendar years 2001 and 2002. The following charts outline the discrepancies for the beginning cash balance, receipts, disbursements and the ending cash balance for each year. Succeeding paragraphs address the reasons for the misstatements.

2001 Committee Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash Balance @ January 1, 2001	\$184,999	\$181,586	\$3,413 Overstated
Receipts	\$1,752,895	\$1,688,418	\$64,477 Overstated
Disbursements	\$1,776,718	\$1,766,900	\$9,818 Overstated
Ending Cash Balance @ December 31, 2001	\$161,176	\$103,104	\$58,072 Overstated

The \$3,413 overstatement of the beginning cash balance on January 1, 2001 could not be explained.

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The net overstatement of receipts resulted from the following:

• In-kind contribution disclosed but not included in reported totals	+ \$ 1,661
• Reported receipts not supported by a deposit	- 88,655
• Contribution amount reported incorrectly	+ 500
• Contributions from individuals and political committees not reported	+ 11,800
• Transfers from non-federal account reported incorrectly	+ 8,238
• Unexplained difference.	+ <u>1,979</u>
Total net overstatement of receipts	<u>\$ (64,477)</u>

The net overstatement of disbursements resulted from the following:

• Reported disbursement paid by Non-federal account	- \$ 15,711
• In-kind contributions not reported	+ 3,180
• Unreported operating expenditures	+ 8,569
• Reported disbursements subsequently voided but not adjusted	- 4,584
• Unexplained difference.	- <u>1,272</u>
Total net overstatement of disbursements	<u>\$ (9,818)</u>

As a result of the misstatements detailed above, the ending cash on hand was overstated by \$58,072.

2002 Committee Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash Balance @ January 1, 2002	\$161,176	\$103,104	\$58,072 Overstated
Receipts	\$1,817,147	\$1,942,863	\$125,716 Understated
Disbursements	\$1,902,233	\$1,942,857	\$40,624 Understated
Ending Cash Balance @ December 31, 2002	\$76,090	\$103,110	\$27,020 Understated

The overstatement of the beginning cash balance on January 1, 2002, was the result of the discrepancies detailed above for 2001.

The understatement of receipts resulted from the following:

• In-kind contributions disclosed as memo and not included in reported totals	+ \$ 750
• PAC and individual contributions not reported	+ 66,750
• Transfers from non-federal account reported incorrectly	+ 19,195
• Unexplained difference.	+ <u>39,021</u>
Total understatement of receipts	<u>\$ 125,716</u>

The net understatement of disbursements resulted from the following:

• In-kind contributions not reported	+ \$ 750
• Unreported operating expenditures	+ 43,997
• Net mathematical error overstating expenditures	- 1,000
• Voided expenditure reported in error	- 850
• Unexplained difference.	- <u>2,273</u>

Total net understatement of disbursements	\$ <u>40,624</u>
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As a result of the misstatements detailed above, the ending cash on hand at December 31, 2002 was understated by \$27,020.

At the exit conference, the Audit staff explained the misstatements and provided ARMPAC's representative with schedules detailing these discrepancies. The representative stated that she would review the spreadsheets provided and amend reports accordingly.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that ARMPAC amend its reports to correct the misstatements noted above; and, in addition, its most recent report should be amended to show the adjusted cash-on hand balance with an explanation that it resulted from audit adjustments from a prior period. In response to the interim audit report, ARMPAC filed amended disclosure reports that materially corrected the misstatements noted above.

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Finding 2. Reporting of Debts and Obligations

Summary

ARMPAC failed to report debts owed to 25 vendors in the amount of \$322,306. The Audit staff recommended that ARMPAC amend its disclosure reports to include these debts. In response to the interim audit report, ARMPAC filed amended reports that materially disclosed the debts noted above.

Legal Standard

A. Continuous Reporting Required. A political committee must disclose the amount and nature of outstanding debts and obligations until those debts are extinguished. 2 U.S.C §434(b)(8) and 11 CFR §§104.3(d) and 104.11(a).

B. Separate Schedules. A political committee must file separate schedules for debts owed by the committee and debts owed to the committee, together with a statement explaining the circumstances and conditions under which each debt and obligation was incurred or extinguished. 11 CFR §104.11(a).

C. Itemizing Debts and Obligations

- A debt of \$500 or less must be reported once it has been outstanding 60 days from the date incurred (the date of the transaction); the committee reports it on the next regularly scheduled report.
- A debt exceeding \$500 must be disclosed in the report that covers the date on which the debt was incurred. 11 CFR §104.11(b).

Facts and Analysis

Disclosure reports filed during the audit period did not disclose any debts owed by ARMPAC. The Audit staff reviewed disbursements and identified debts owed to 25 vendors, totaling \$322,306, which should have been disclosed on Schedules D (Debts and Obligations excluding Loans). The majority of the debts were outstanding over several reporting periods but not reported. In order to derive the total debts not reported, each outstanding debt was counted only once, even if it was outstanding for several periods.

ARMPAC's representative was informed of this matter at the exit conference and provided a schedule detailing the debts requiring disclosure. She indicated that the amended Schedules D would be filed.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that ARMPAC amend its reports to disclose the debts and obligations addressed above on Schedules D as required. In response to the interim audit report, ARMPAC filed amended reports which included Schedules D that materially disclosed these debts.

Finding 3. Non-federal Funding of Federal Activity

Summary

A review of expenditures made from federal and non-federal accounts indicated that the non-federal account potentially paid more than its share of allocable expenses by \$211,281. Contributing significantly to this result was the allocation ratio for administrative expenses used by ARMPAC. ARMPAC allocated 50% of its administrative expenses to the non-federal account, instead of 7%. In addition, ARMPAC made disbursements that appear to be allocable between the federal and non-federal accounts from its non-federal account rather than from its federal account. The Audit staff recommended that ARMPAC either demonstrate there had been no over funding by the non-federal account or reimburse the non-federal account \$211,281 and correct its disclosure of the expenditures. In response to the interim audit report, ARMPAC provided additional documentation that reduced the liability to the non-federal account to \$203,483 and amended its disclosure reports to reflect these changes.

Legal Standard

A. Accounts for Federal and Non-federal Activity. A committee that finances political activity in connection with both federal and non-federal elections must establish two accounts (federal and non-federal) and allocate shared expenses--those that simultaneously support federal and non-federal election activity—between the two accounts. Alternatively, the committee may conduct both federal and non-federal activity from one bank account, considered a federal account. 11 CFR §102.5(a)(1)(i).

B. Federal vs. Non-federal Account. The federal account may contain only those funds that are permissible under the federal election law; the non-federal account may contain funds that are not permitted under the federal law (but are legal under state law), such as contributions that exceed the limits of the federal law and contributions from prohibited sources, such as corporations and labor organizations. 11 CFR §102.5(a)(1)(i) and (a)(3).

C. Reporting Allocable Expenses. A political committee that allocates federal/non-federal expenses must report each disbursement it makes from its federal account (or separate allocation account) to pay for a shared federal/non-federal expense. Committees report these kinds of disbursements on Schedule H4 (Joint Federal/Non-federal Activity Schedule). 11 CFR §104.10(b)(4)

D. Allocation Required for Generic Voter Drives. Nonconnected committees must allocate all of their costs for generic voter drives. A generic voter drive is an activity that urges the general public:

- To register to vote;
- To vote; or
- To support candidates of a particular party or candidates who are associated with a particular issue, without mentioning a specific candidate. 11 CFR §106.6(b)(2)(iii).

E. Determining the Appropriate Allocation Ratio. Nonconnected committees shall allocate administrative expenses and costs of generic voter drives based on the ratio of federal expenditures to total federal and non-federal expenditures. The federal and non-

federal expenditures used in this calculation are limited to expenditures made in direct support of candidates. 11 CFR §106.6(c)(1)

F. Allocation Ratio for Shared Fundraising Expenses. If a committee raises both federal and non-federal funds through the same fundraising program or event, it must allocate the direct cost of the fundraising event based upon the ratio of funds received by the federal account to the total amount raised for the event. 11 CFR §106.5(f)(1).

Facts and Analysis

ARMPAC maintained separate federal and non-federal bank accounts. It paid shared expenses from the federal account and transferred funds from the non-federal account to the federal account to cover the non-federal share of those expenses. ARMPAC paid allocable expenses for administrative and generic get out the vote (GOTV) expenses from the federal account using a ratio of 50% federal and 50% non-federal and disclosed this ratio on its Schedules H1 (Method of Allocation for Shared Federal and Non-federal Administrative Expenses and Generic Voter Drive Costs). The Audit staff reviewed disbursements from both the federal and non-federal accounts and found that the non-federal had potentially over funded its share of allocable expenses by \$211,281. The succeeding paragraphs address the issues noted by the Audit staff.

A. Incorrect Ratio Used for Administrative and Generic Get-Out-the-Vote (GOTV) Expenses

As noted above, ARMPAC paid allocable expenses for administrative and generic get-out-the-vote expenses from the federal account using a ratio of 50% federal and 50% non-federal. The Audit staff reviewed direct candidate support by ARMPAC in order to determine the correct allocation ratio for such expenses. ARMPAC contributed a total of \$1,120,600 directly to candidates; \$1,046,000 to federal candidates and \$74,600 to non-federal candidates. Based on this information, the Audit staff calculated the allocation ratio to be 93% federal ($\$1,046,000 / \$1,120,600$) and 7% non-federal ($\$74,600 / \$1,120,600$). ARMPAC calculated that the non-federal share of administrative and GOTV expenses was \$141,225; the Audit staff's calculation is \$19,769 at 7%. Therefore, the non-federal overpaid its portion of such allocable expenses by \$121,456 ($\$141,225 - \$19,769$).

B. Incorrect Ratio Used for Fundraising Event Expenses

ARMPAC paid allocable expenses for eight fundraising events from the federal account using estimated ratios of federal and non-federal receipts for each event and disclosed these ratio on Schedule H2 (Allocation Ratios). The following schedule shows the ratio reported by ARMPAC and the ratio calculated by the Audit staff based on available records:

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Fundraising Event Ratios		
Event Name and Date	Reported Ratio % Federal/Non-federal	Audit Ratio % Federal/Non-federal
Four Streams 2001 (7/23/01)	20/80	17/83
Puerto Rico 2001 (9/10/01)	15/85	8/92
Hackberry 2001 (10/24/01)	50/50	40/60
Orlando 2001 (11/2/01)	15/85	12/88
Puerto Rico 2002 (2/25/02)	15/85	10/90
California 2002 (3/26/02)	20/80	47/53
Four Streams 2002 (4/19/02)	15/85	28/72
New York 2002 (6/1/02)	40/60	18/82

On Schedule H4, ARMPAC reported \$126,511 as the non-federal share of expenses relative to the eight fundraising events. The Audit staff applied it's ratios to these fundraising expenses and determined the non-federal portion to be \$117,097. Thus, the non-federal had overpaid its share by \$9,414.

C. Federal Share of Allocable Expense Made from the Non-federal Account

The Audit staff's review of non-federal disbursements identified 112 payments totaling \$418,352 to consulting/fundraising vendors for fundraising expenses. ARMPAC provided contracts and affidavits that describe services provided by these vendors as non-federal fundraising activity, developing strategies and objectives for the organization; implementing direct mail and telemarketing efforts; and providing guidance with respect to the committee's role in non-federal races and state party activity. Therefore, ARMPAC contends that these vendor payments were solely non-federal expenses.

Documentation provided to date does not show a separate non-federal fundraising activity. On the contrary, the fundraising ratios developed above resulted from documentation provided by ARMPAC which indicates the events were shared fundraising efforts for both the federal and non-federal accounts. Further, the Audit staff notes that some payments were made to these vendors by ARMPAC and disclosed on Schedules H4 (Joint Federal/Non-federal Activity Schedule) as shared expenses. As such, the Audit staff considers these payments to be for shared activity.

In the absence of documentation allowing the Audit staff to associate these expenses with specific fundraising events, a simple average, federal fundraising ratio was calculated based on the fundraising event ratios described above in Finding 3.B. – Incorrect Ratio used for Fundraising Event Expenses. This ratio has been applied to determine the federal portion of the expense paid from the non-federal account to be \$94,129, or 22.5% of \$418,352.

In addition, ARMPAC reported a \$15,710 fundraising expense for a 2001 Puerto Rico event which was paid directly from the non-federal account. The Audit staff's calculated fundraising ratio for this event was 8% as described above in Finding 3.B. – Incorrect Ratio used for Fundraising Event Expenses, therefore the federal portion of this allocable expenditure was calculated to be \$1,257, or 8% of \$15,710.

Therefore, the non-federal had paid the federal's portion of shared expenses, which totaled \$95,386 (\$94,129 + \$1,257).

The Audit staff presented this matter at the exit conference and provided ARMPAC's representative with schedules detailing the expenditures. The representative expressed a willingness to review the spreadsheets provided, file amended reports and understood a payment from the federal account to the non-federal account may be required.

Interim Audit Report Recommendation and Committee Response

The Audit staff recommended that ARMPAC demonstrate the identified disbursements paid by the non-federal account are not allocable expenses by providing documentation that the fundraising was solely non-federal in nature, the Audit staff's administrative/generic get-out-the-vote and fundraising ratios as calculated above are incorrect, and/or there has been no over funding by the non-federal account. Absent such a demonstration, it was recommended that ARMPAC:

- File a Schedule H1 to correctly disclose the administrative/gotv allocation ratio;
- File a Schedule H2 to correctly disclose the fundraising event allocation ratios;
- File Schedules H4 disclosing the payments from the non-federal account as memo entries that include the total amount paid, the federal share, and the non-federal share;
- Footnote each memo entry on Schedule H4 to say "recognize payments of allocable expenses from the non-federal account"; and
- Use funds from its federal account to reimburse the non-federal account \$211,281 and provide evidence of such reimbursement. If ARMPAC lacked the funds to make the reimbursement, it should have disclosed the amount owed as a debt on Schedule D until such time as funds became available to make the reimbursement.

In response to the interim audit report, ARMPAC submitted documentation and filed amended disclosure reports addressing each of the matters presented above.

With respect to Finding 3.A. above, Incorrect Ratio Used for Administrative and Generic Get-Out-the-Vote (GOTV) Expenses, ARMPAC, as part of its response, submitted an

amended Schedule H1 correcting its ratio from the 50% federal/50% non-federal it had utilized to the 93% federal/7% non-federal calculated by the Audit staff. In addition, amended Schedules H4 were submitted correcting the disclosure of shared administrative/GOTV expenditures to reflect the correct ratio and decreasing the non-federal share by \$121,456. The Non-Federal Funding Analysis (the Analysis) on page 12 reflects these corrections.

With respect to Finding 3.B. above, Incorrect Ratio Used for Fundraising Event Expenses, in response to the interim audit report, ARMPAC provided additional documentation detailing the receipts collected relative to each of the fundraising events. The Audit staff reviewed the documentation and revised its fundraising ratios accordingly. Based on the revised ratios, the Audit staff re-calculated the non-federal share of expenses associated with these events and determined it had overpaid by \$8,205 (\$126,511 originally reported - \$118,306 amended reports); down from the \$9,414 calculated in the interim audit report. As part of its response, ARMPAC submitted amended Schedules H2 to disclose the correct fundraising ratio for each event and amended Schedules H4 to correct the disclosure of the shared fundraising expenditures impacted by the revised ratios. The Analysis on page 12 reflects these corrections.

Finally, with respect to Finding 3.C., Federal Share of Allocable Expense Made from the Non-federal Account, based on the revised fundraising event ratios discussed above, the Audit staff calculated a revised, simple average federal fundraising ratio. This ratio has been applied to determine the federal portion of the \$418,352 fundraising expenses paid from the non-federal account to be \$87,854 (21% of \$418,352). ARMPAC's response did not dispute this matter, and included amended Schedules H4 (memo entries) to disclose these expenditures.

In addition, the federal portion of a \$15,710 fundraising expense for a 2001 Puerto Rico event which was paid directly from the non-federal account was re-calculated using the revised fundraising ratio for this event as detailed above. The federal portion of this allocable expenditure is \$943, or 6% of \$15,710.

The total adjustment for the federal share of allocable expenses made from the non-federal account on the Analysis is \$88,797 (\$87,854 + \$943).

Based on ARMPAC's response, the Audit staff prepared the Analysis that appears below.

Non-federal Funding Analysis		
Description	Finding Index	
Net Transfers made from Non-federal Accounts		\$ 252,761
Less: Non-federal Portion of Allocable Expenditures per amended reports filed by ARMPAC on 06-24-05 in response to the interim audit report.		<u>(138,075)¹</u>
Net (Under funding)/Over funding by the Non-federal Account:		\$ 114,686
Adjustment:		
Federal Share of Allocable Expenses made from the Non-federal Account	Finding 3. C.	\$ 88,797
Adjusted Amount of Non-federal OVER Funding of Allocable Expenses		\$ 203,483

The Analysis indicates that the non-federal account has over funded its share of allocable expenses by \$203,483. ARMPAC amended its Schedule D to reflect this as a debt owed to "Americans for a Rep. Majority NonFed Acct."

¹ This figure is the non-federal portion of allocable expenditures originally reported (\$267,736) adjusted for amended reports which reduced the non-federal portion of administrative and generic get-out-to-vote expenses by \$121,456 and fundraising event expenses by \$8,205.